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SEC Moves on Indexed Annuities

On June 25, the Securities and Exchange Commission ("SEC") proposed a new Rule 151A which will alter the treatment of indexed annuities. Under this rule, indexed annuities with certain characteristics would be defined as securities and subject to the oversight of the SEC. The rule would become fully effective one year after adoption and would exempt policies sold prior to the effective date. The comment period for the new rule expires on September 10. The proposed rule may be found at: http://www.sec.gov/rules/proposed/2008/33-8933.pdf. There are four ways of submitting comments on the proposed rule

- Use the internet comment form: http://www.sec.gov/rules/proposed.shtml
- Send e-mail with File Number S7-14-08 on the subject line: rule-comments@sec.gov.
- Use the Federal eRulemaking Portal: http://www.regulations.gov
- Mail comments, in triplicate, to: Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090

In claiming jurisdiction over indexed annuities, the SEC is making two determinations

1. The allocation of investment risk between the insurance company and the purchaser is such that the insurance company does not accept significant investment risk. Further, the SEC argues that indexed annuities are not eligible for the Rule 151 exemption. This is the "safe harbor" that permits many annuities to not be considered investments for SEC purposes. They cite that these annuities do not guarantee that excess interest will not be modified more than once per year, a requirement of Rule 151
2. These annuities have been marketed as securities. They assert that the purchasers of these annuities desire to participate in the securities market SEC Chairman Christopher Cox, in a statement at the meeting exposing the proposed rule (http://www.sec.gov/news/speech/2008/spch062508cc_annuity.htm), cites several reasons that the rule is needed

- Sales. In 2007, indexed annuity sales were $25 BN, with over $123 BN currently invested
- Complexity. Indexed annuities are complicated. They have a variety of fees and charges, they have complex limitations on accumulation of funds, they have complex calculations of index values, and they have many other detailed features

- Surrender charges. Some policies have surrender charges of 15% - 20% which may last longer than 15 years
- Senior citizens. There are significant sales to older Americans who are not able to scrutinize the details and who may not be suitable purchasers of these annuities
- Abusive sales practices. In citing this, Commissioner Cox showed a video of a Dateline NBC segment which had hidden cameras at free lunch and dinner seminars. Allegedly, abusive and misleading sales tactics were used at these seminars to entice prospects into purchases

The impact of these rules on the indexed annuity market would be significant. The majority of the producers marketing these products do not have securities licenses. Companies would have to incur the costs of registering their products with the SEC plus all the other requirements which go with the creation and marketing of securities. If adopted as proposed, companies can expect a dramatic reduction in new business when the rule goes into effect.

Companies affected by the new rule, however, are strongly opposing the adoption. Many of the largest writers of indexed annuities have released statements indicating that they will comment on the proposal and work with the SEC. As an intrusion into state regulation, insurance commissioners are also involved in the discussion. Most notably, Commissioner Susan Voss of Iowa met with Commissioner Cox in July. She is hopeful that another meeting with her and other commissioners will take place in Washington, DC during the NAIC's fall national meeting.

It is likely that changes in the regulation of indexed annuities are coming. Although the proposed rules are unlikely to be adopted without some change, it is unclear how much the SEC will defer to state regulation. At the very least, if state regulation is to continue, it will probably become a more aggressive regulation, addressing some of the SEC's concerns.

ABOUT THE AUTHOR

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